UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

MICHAEL STROCK

Debtor

No. 02-13533
Chapter 7

McGLOTHLIN FAMILY CEMETERY COMPANY

Plaintiff

v.

MICHAEL STROCK

Defendant

Adversary Proceeding
No. 02-1176

MEMORANDUM OPINION

Appearances: K. Stephen Powers and Cynthia D. Hall, Shumacker, Witt, Gaither & Whitaker, P.C., Chattanooga, Tennessee, Attorneys for Plaintiff

Thomas E. Ray, Samples, Jennings, Pineda & Ray, Chattanooga, Tennessee, Attorney for Debtor/Defendant

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

McGlothin Family Cemetery Company alleges that Mr. Strock, the debtor, owes it a debt that can not be discharged in his bankruptcy case. The debtor has filed a motion to dismiss the cemetery company's complaint on the ground that it fails to state a claim upon which relief can be granted. Fed. R. Bankr. P. 7012(b); Fed. R. Civ. P. 12(b)(6). This memorandum deals with that motion.

The cemetery company's complaint is based on its dealings with a masonry company, Architectural Stone, Inc. The complaint alleges the debtor was one of the masonry company's two shareholders and represented it in the transactions with the cemetery company. The allegations of the complaint are set out below, beginning with paragraph 4. The complaint identifies the cemetery company as "McGlothlin" and the masonry company as "Architectural Stone".

> 4. Debtor is indebted to McGlothlin in the total amount of $77,589.34, plus interest. Debtor obtained this money from McGlothlin based on fraudulent and willful misrepresentations by Debtor which fraudulently induced McGlothlin to enter into a contract with Debtor and his Company Architectural Stone.
>
> 5. To the best of Plaintiff's knowledge and belief, at all times material hereto, Debtor and his partner John F. Farrar were the sole owners and were directors and officers of Architectural Stone, Inc.
>
> 6. On or about February 1, 2001, McGlothlin entered into a contract with Architectural Stone, Inc. . . . whereby Architectural Stone, Inc., agreed to construct and furnish materials for the erection of a pavilion at the McGlothlin Family Cemetery in Buchanan County, Virginia for the total contract price of . . . ($110,841.92) . . . .
>
> 7. The Contract was entered into by McGlothlin based on its reliance upon fraudulent misrepresentations made by or on behalf of Debtor. These fraudulent misrepresentations included the assertion that Architectural Stone, Inc. was a viable corporation and was capable and financially able to furnish the materials and labor specified in the

Contract and to perform the Contract in all respects.

8. The terms of the Contract required McGlothlin to pay . . . (35%) of the total contract price . . . ($38,794.67), upon execution of the contract.

9. Based upon fraudulent representations made by or on behalf of Debtor, McGlothlin made the advance payment of . . . ($38,794.67) . . . on February 1, 2001 . . . .

10. On or about March 25, 2001, Architectural Stone, Inc. supplied McGlothlin with a proposed production schedule for the pavilion. This schedule provided that the pavers would be delivered on site the week of April 9, 2001, the columns would be delivered the week of May 7, 2001, and the cornices would be delivered the week of June 11, 2001 . . . .

11. Upon agreement of the parties, the second installment of the Contract price was to be paid before the expected shipping date of the first shipment.

12. In reliance upon the fraudulent misrepresentations made by or on behalf of Debtor, that the items would be shipped as scheduled, McGlothlin paid the second installment of the Contract price by check dated March 28, 2001, in the amount of . . . ($38,794.67) . . . .

13. Upon information and belief, the annual report required for Architectural Stone, Inc., to maintain its corporate status was to be filed with the Tennessee Secretary of State on April 1, 2001, four (4) days after McGlothlin made its second installment payment pursuant to the Contract. This report was not filed, and Architectural Stone was administratively dissolved on September 21, 2001.

14. Although the annual report was due prior to the first scheduled delivery date of items under the contract, McGlothlin was never informed that this report was not going to be filed, that Architectural Stone, Inc., was not going to maintain its corporate status or that Architectural Stone, Inc., was unable to comply with its obligations under the Contract. It was specifically represented that Architectural Stone, Inc. could and would fulfill its obligations under the Contract.

15. Upon information and belief, Architectural Stone, Inc. was experiencing severe financial difficulties at the time it entered into the Contract with McGlothlin. These financial difficulties were such that it was virtually impossible for Architectural Stone, Inc. to have the

funds to fulfill its obligations under the Contract. Debtor was aware of this financial situation but failed to advise McGlothlin that it would not be able to fulfill the Contract.

16. McGlothlin began construction at the job site at McGlothlin Family Cemetery on April 1, 2001, in anticipation of the first scheduled delivery of the pavers during the week of April 9, 2001.

17. The pavers were not delivered the week of April 9, 2001, and were not delivered until the week of April 26, 2001. None of the other materials was ever delivered to the job site.

18. During the months of April, May and June 2001, representatives of McGlothlin had numerous telephone conversations with Debtor. Debtor continued to assure McGlothlin that the materials would be delivered and the Contract would be performed. Debtor did not mention to McGlothlin that the company was having financial difficulties, was going out of business, or was financially unable to furnish the materials or labor for which McGlothlin had paid.

COUNT 1 - F R A U D U L E N T O R N E G L I G E N T MISREPRESENTATION

. . . .

20. Debtor fraudulently misrepresented to McGlothlin that Architectural Stone, Inc. was a viable corporation and capable in all respects of furnishing the materials and labor to McGlothlin for construction of a pavilion at the McGlothlin Family Cemetery.

21. In reliance upon these misrepresentations, McGlothlin paid a total of . . . ($77,589.34) to Architectural Stone, Inc. under the Contract. The only items McGlothlin received . . . for this payment were pavers with a total value under the Contract of . . . ($3,907.20). Although McGlothlin was able to use these pavers, they do not match the color of the other stones and material ultimately used in the construction . . . and thus diminished the value of the entire project.

22. As a result of the fraudulent misrepresentations made by or on behalf of Debtor, McGlothlin was damaged in the principal amount of . . . ($77,589.34).

COUNT II - CONVERSION

. . . .

24. McGlothlin paid Architectural Stone, Inc. a total sum of . . . ($77,589.34) which was to be used for the furnishing of materials and labor for its pavilion at the McGlothlin Family Cemetery.

25. This money was not used to purchase, construct, deliver and erect the materials for McGlothlin's pavilion but, to the best of McGlothlin's knowledge, information and belief, was converted by the Debtor for his own use in paying other individual or corporate liabilities or was otherwise unlawfully converted by them.

26. As a result of the fraudulent conversion by the Debtor, McGlothlin has suffered damages in the principal amount of . . . ($77,589.34).

COUNT III - BREACH OF CONTRACT

. . . .

28. Alternatively, McGlothlin had a valid Contract with Architectural Stone, Inc. to furnish it with materials and labor for the construction of the pavilion.

29. McGlothlin fulfilled its obligations under said Contract and made total payments . . . of . . . ($77,589.34).

30. Architectural Stone, Inc. and Debtor breached the Contract by failing to provide the materials agreed upon and McGlothlin is thus entitled to a recovery of . . . ($77,589.34) . . . .

COUNT IV - PIERCING THE CORPORATE VEIL

. . . .

32. Debtor accepted money from McGlothlin in the name of and on behalf of Architectural Stone, Inc., even though he knew that corporate formalities were not being complied with, and he had no intention to comply with corporate formalities.

33. The first delivery was due under the contract during the week of

> April 9, 2001, the week following the due date for Architectural Stone, Inc.'s annual report to be filed with the Secretary of State.
>
> 34. Debtor accepted payment prior to this scheduled delivery date even though he knew, or should have known, that he was not complying with corporate formalities, he did not intend to comply with corporate formalities or maintain Architectural Stone, Inc. as a viable corporation and that Architectural Stone, Inc. would not perform the Contract.
>
> 35. Although Debtor was aware that corporate formalities were not being followed, he continued to use the corporate format as a shield to individual liability and continued to accept payments from McGlothlin while concurrently depleting corporate funds. Thus, he is individually liable to McGlothlin for corporate debts.
>
> 36. Debtor accepted McGlothlin's money even though he knew, or should have known, that Architectural Stone, Inc., was not able or capable of fulfilling its obligations under the Contract and/or would not do so.
>
> 37. As a result of the actions of Debtor, McGlothlin has suffered damages in the principal amount of . . . ($77,589.34).

The complaint asks the court to hold that the debt is non-dischargeable under Bankruptcy Code § 523(a)(2), (a)(4) or (a)(6). 11 U.S.C. § 523(a)(2), (4), (6). The debtor's motion to dismiss asserts that the complaint fails to state a claim for relief under any of these statutes. Fed. R. Bankr. P. 7012(b); Fed. R. Civ. P. 12(b)(6). For purposes of ruling on the motion, the court accepts as true the facts alleged in the complaint and the reasonable inferences from those facts. The court views the allegations of the complaint in the light most favorable to the cemetery company. The court should grant the motion only if the court is certain the cemetery company cannot prove any set of facts that is consistent with the complaint's allegations and will entitle the cemetery company to relief. *United Food and Commercial Workers International Union Local 199 v. United Food and*

Commercial Workers International Union, 301 F.3d 468 (6th Cir. 2002).

Before considering whether to dismiss the claims under § 523(a), the court needs to deal with problems concerning the other two counts of the complaint: (1) the count that asks the court to pierce the corporate veil of the masonry company, and (2) the count that asserts a claim for damages for breach of the construction contract.

Piercing the corporate veil

Generally, a shareholder, officer, or director of a corporation is not personally liable for its debts. But a creditor may be able to show grounds for "piercing the corporate veil" to make the officer, director, or shareholder personally liable. 18 Am.Jur.2d, Corporations § 43.

Piercing the corporate veil is often unnecessary to prove that a shareholder, director, or officer or a corporation owes a non-dischargeable debt as the result of acts he took on the corporation's behalf. For example, when an officer of the corporation obtains property for the corporation by wrongful means – such as fraud or willful and malicious conversion – he personally commits a tort. He is personally liable to the injured person for the resulting damages, and they are a non-dischargeable debt under § 523(a). *See, e.g., Capitol Indemnity Corp. v. Interstate Agency, Inc. (In re Interstate Agency, Inc.)*, 760 F.2d 121 (6th Cir. 1985); *Vulcan Coals, Inc. v. Howard*, 946 F.2d 1226 (6th Cir. 1991); *Airlines Reporting Corp. v. Ellison (In re Ellison)*, 296 F.3d 266 (4th Cir. 2002); *Lawrence Freight Lines, Inc. v Transport Clearings-Midwest, Inc., (In re Transport Clearings-Midwest, Inc.)* 16 B.R. 890 (Bankr. W. D. Mo. 1979); *First Colony Life Ins. Co. v. Coover (In re Coover)*,

70 B.R. 554 (Bankr. S. D. Fla. 1987); 18B Am.Jur.2d, Corporations § 1882 (2002). The cemetery company's complaint alleges the debtor himself carried out the wrongdoing and is personally liable for that reason, without piercing the corporate veil.

With regard to § 523(a)(2), a related question has regularly come up. Suppose a an officer of the corporation fraudulently obtains a loan for the corporation. He may argue that he does not owe a non-dischargeable debt because he did not obtain anything for himself. In *Brady* the court of appeals assumed, for the purpose of argument, that the debtor obtains something under § 523(a)(2) only if he receives a benefit from it. The court held the benefit requirement was satisfied because the money went to a corporation in which the debtor was a major shareholder. *Brady v. McAllister (In re Brady)*, 101 F.3d 1165, 30 Bankr.Ct.Dec. 15, 37 Collier Bankr.Cas.2d 218 (6th Cir. 1996). Based on that reasoning, the cemetery company's complaint adequately alleges a benefit to the debtor. It alleges the debtor was a major shareholder in the masonry company that received the payments from the cemetery company. Furthermore, the rule that liability under § 523(a)(2) requires a personal benefit to the debtor may have been overruled by the reasoning of *Cohen v. De La Cruz*, 523 U.S. 213, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998).

The debtor contends piercing the corporate veil is irrelevant because it can make him personally liable for the masonry company's debt, but it will not establish that the debt is non-dischargeable, and he has listed the cemetery company as a creditor in his bankruptcy case so that dischargeability is the only possible question as to any debt he may owe the cemetery company.

In a situation such as this, there are at least two theories of liability for the corporation and two for the individual officer, shareholder, or director who represented it:

> (1) the corporation is liable for breach of contract;
>
> (2) the corporation is liable in tort (such as misrepresentation, fraud, false pretenses, conversion);
>
> (3) the individual is liable for the corporation's debts by means of piercing the corporate veil;
>
> (4) the individual is personally liable in tort because he carried out or assisted in carrying out the tort on behalf of the corporation.

Whether a debt can be excepted from discharge is not relevant to a corporation in a Chapter 7 liquidation case because the corporation cannot receive a discharge; only an individual can receive a discharge. 11 U.S.C. §§ 727(a)(1) & 523(a). Nevertheless, the courts apparently follow the rule that when the corporation's debt would be non-dischargeable, if the corporation were an individual, then the debt is non-dischargeable as to an individual debtor who is made liable for the debt by piercing the corporate veil. C*f. Alport v. Ritter (In re Alport)*, 144 F.3d 1163 (8th Cir. 1998); *United States v. WRW Corp.*, 986 F.2d 138 (6th Cir. 1993); *Simek v. Erdman (In re Erdman)*, 236 B.R. 904 (Bankr. D. N. D. 1999).

Of course, the facts that justify piercing the corporate veil will not necessarily prove the debt should be excepted from discharge. *Molo Oil Co. v. Botten (In re Botten)*, 54 B.R. 707 (Bankr. W. D. Wis. 1985); *United States v. Bagel (In re Bagel)*, 1992 WL 477052 (Bankr. E. D. Pa. 1992). This does not mean that piercing the corporate veil is

always irrelevant to dischargeability. It depends on which particular debt the plaintiff is attempting to except from discharge – the corporation's debt or the individual debtor's separate tort debt. The cemetery company apparently wants to pursue both. The question raised by the debtor's brief is whether the debtor intends to concede that the corporate veil can be pierced.

The court thinks the debtor's brief does not go that far. The debtor is arguing for dismissal on the ground that the alleged facts fail to state a claim under § 523(a)(2), (4), or (6). As to piercing the corporate veil, the point of the debtor's brief is that the allegations on that issue do not add anything to the cemetery company's claims under § 523(a)(2), (4), or (6). The court will not dismiss the count of the complaint that asks for piercing the corporate veil.

Breach of contract damages

A breach of contract may involve the kind of wrongdoing that will justify excepting the debt for damages from discharge under § 523(a)(2), (4) or (6). A breach of contract may amount to embezzlement, larceny, willful and malicious injury, or fraud or defalcation while acting in a fiduciary capacity; a breach of contract may involve fraud, false representation, or false pretenses even if the breach itself is none of those. *Petralia v. Jercich (In re Jercich)*, 238 F.3d 1202 (9th Cir. 2001); *Spring Works, Inc. v.Sarff (In re Sarff)*, 242 B.R. 620 (6th Cir. B.A.P. 2000); *Schroeder v. Busick (In re Busick)*, 264 B.R. 518 (Bankr. N. D. Ind. 2001); *Glenn v. Hrim (In re Hrim)*, 196 B.R. 237 (Bankr. N. D. N. Y. 1993); *Carlisle Cashway, Inc. v. Johnson (In re Johnson)*, 691 F.2d 249 (6th Cir. 1982);

Spinoso v. Heilman (In re Heilman), 241 B.R. 137 (Bankr. D. Md. 1999). Furthermore, the damages for breach of contract may be entirely or partially included in a debt that is non-dischargeable under § 523(a)(2), (4), or (6). *Compare Telmark, LLC v. Booher (In re Booher)*, 284 B.R. 191 (Bankr. W. D. Pa. 2002) *and*, *Herbstein v. Bruetman (In re Bruetman)*, 259 B.R. 649 (Bankr. N. D. Ill. 2001).

The court is not saying that damages for a breach of contract will automatically come within any of the discharge exceptions. To be excepted from discharge, a debt must still come within one of the exceptions from discharge. *See Cohen v. De La Cruz*, 523 U.S. 213, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998). The court's point is that dismissing the breach of contract claim would be premature. The question of whether damages for breach of contract are non-dischargeable under § 523(a)(2), (4) or (6) will still come up under those provisions.

Section 523(a)(4)

Section 523(a)(4) excepts four kinds of debts from discharge: (1) a debt resulting from the debtor's fraud while acting in a fiduciary capacity; (2) a debt resulting from the debtor's defalcation while acting in a fiduciary capacity; (3) a debt resulting from embezzlement by the debtor; (4) a debt resulting from larceny by the debtor. 11 U.S.C. § 523(a)(4).

The debtor's argument for dismissal focuses on (1) and (2) – the fiduciary capacity debts. Fiduciary capacity requires a technical or express trust that was created by agreement or statute. The trust must have existed before the debtor's fraud or

defalcation. *R. E. America, Inc. v. Garver (In re Garver)*, 116 F.3d 176 (6th Cir. 1997); *Kriegish v. Lipan (In re Kriegish)*, 275 B.R. 838 (E. D. Mich. 2002).

The last requirement deals with trusts created by the courts to remedy wrongdoing. For example, when a debtor has obtained property from a creditor by fraud or other wrongdoing, a court may treat the debtor as a trustee of the property for the benefit of the creditor. This kind of trust is an equitable remedy, not a technical or express trust that existed before the debtor's wrongdoing. *XL/Datacomp, Inc. v. Wilson (In re Omegas Group, Inc.)*, 16 F.3d 1443, 25 Bankr.Ct.Dec. 413 (6th Cir. 1994). If the court assumes the debtor acquired money from the cemetery company by fraud or other wrongdoing, that wrongdoing could not have created the kind of fiduciary capacity required by § 523(a)(4). *R. E. America, Inc. v. Garver (In re Garver)*, 116 F.3d 176 (6th Cir. 1997); *Zio Johnos Inc. v. Ziadeh (In re Ziadeh)*, 284 B.R. 893 (Bankr. N. D. Iowa 2002).

A construction contractor generally does not receive the owner's payments in trust to be used for the owner's project. *Lisk v. Criswell (In re Criswell)*, 52 B.R. 184 (Bankr. E. D. Va. 1985); *Kannon v. Blalock (In re Blalock)*, 15 B.R. 33 (Bankr. E. D. Tenn. 1981). The construction contract between the cemetery company and the masonry company is attached to the complaint. It does not include terms that can be construed to make the debtor or the masonry company a trustee of the payments received from the cemetery company.

State law can make a contractor a fiduciary for the purposes of § 523(a)(4), but the complaint does not allege that state law made the debtor a fiduciary for the

cemetery company. *Sandak v. Dobrayel (In re Dobrayel)*, 287 B.R. 3 (Bankr. S. D. N. Y. 2002); *Kriegish v. Lipan (In re Kriegish)*, 275 B.R. 838 (E. D. Mich. 2002).

The conversion count of the complaint asserts that the cemetery company's payments were to be used for its project, and the debtor converted them by using them for other purposes. With regard to whether the debtor was a fiduciary, this statement adds nothing to the complaint. It states conclusions without any alleged facts to show or imply that the debtor received the payments under an express or technical trust for the cemetery company's benefit.

In summary, the allegations of the complaint are not sufficient to support a claim under § 523(a)(4) for fraud of defalcation by the debtor while acting in a fiduciary capacity. The court will, however, allow the cemetery company the opportunity to amend the complaint to cure the problem.

The debtor's brief does not discuss whether the complaint states a claim for relief under § 523(a)(4) based on embezzlement or larceny by the debtor. In the interest of efficiency, however, the court will deal with those questions.

Embezzlement requires proof the debtor lawfully obtained possession or control of another person's property and then took the property for his own use. *Spinoso v. Heilman (In re Heilman)*, 241 B.R. 137 (Bankr. D. Md. 1999). Implicit in embezzlement is the other person's intent to remain the owner of the property despite the debtor's possession or control. *D'Agata v. Hogan (In re Hogan)*, 193 B.R. 142 (Bankr. N. D. N. Y. 1995).

The alleged facts do not show or even imply that the debtor or the masonry company had possession or control of property that belonged to the cemetery company. If the debtor or the masonry company obtained the progress payments by fraud or other wrongdoing, the payments still became the masonry company's property. As a result, the debtor could not have embezzled the payments from the cemetery company. *Heeter v. Birt (In re Birt)*, 173 B.R. 346 (Bankr. N. D. Ohio 1994); *Bombardier Capital, Inc. v. Dobek (In re Dobek)*, 278 B.R. 496 (Bankr. N. D. Ill. 2002); *Spinoso v. Heilman (In re Heilman)*, 241 B.R. 137 (Bankr. D. Md. 1999).

The same reasoning applies to a claim under § 523(a)(6) for willful and malicious conversion. The alleged facts do not show or imply that the cemetery company had any interest in the progress payments after payment to the masonry company. *Gadtke v. Bren (In re Bren)*, 284 B.R. 681 (Bankr. D. Minn. 2002); *see also Belfry v. Cardozo (In re Belfry)*, 862 F.2d 661 (8th Cir. 1988). Thus, the debtor could not have willfully and maliciously converted the progress payments.

The court's conclusions up to this point leave other claims under the complaint that may not be subject to dismissal under Rule 12(b)(6). The debt may be excepted from discharge under § 523(a)(4) if the debtor obtained the payments by larceny. The debt may be excepted from discharge under § 523(a)(6) if the debtor willfully and maliciously injured the cemetery company, even if the injury was not conversion. The court will deal with those issues later. First, the court will deal with the other possible exception from discharge § 523(a)(2).

Section 523(a)(2)

Section 523(a)(2) generally excepts from discharge a debt for obtaining money, property, or credit by fraud, false pretenses, or false representation. 11 U.S.C. § 523(a)(2). The cemetery company's complaint relies heavily on allegations that the debtor failed to reveal the masonry company's financial inability to carry out the contract. The complaint also asserts an implied representation by the debtor that the masonry company had the financial ability to carry out the contract.

Courts have held that a misrepresentation of financial condition is a ground for excepting a debt from discharge under § 523(a)(2) only if the misrepresentation was written; an implied misrepresentation of financial condition will not prevent discharge of the debt. *Commercial Money Center, Inc. v. Sacco (In re Sacco)*, 270 B.R. 382 (Bankr. W. D. Pa. 2001); *Minnesota Client Security Board v. Wyant (In re Wyant)*, 236 B.R. 684 (Bankr. D. Minn. 1999). Likewise, failure to disclose poor financial condition may not be a ground for excepting a debt from discharge under § 523(a)(2). *Gadtke v. Bren (In re Bren)*, 284 B.R. 681 (Bankr. D. Minn. 2002). Based on this reasoning, the debtor contends the cemetery company's claim under § 523(a)(2) should be dismissed.

The court disagrees with the debtor's view of the complaint. The gist of the complaint is that the debtor induced the cemetery company to enter into a construction contract with the masonry company when the debtor knew or should have known the masonry company could not perform the contract. The implication is that the debtor and the masonry company did not honestly intend to carry out the contract, either when the

contract was entered into or when the progress payments were received. In summary, the complaint alleges an implied representation that the debtor and the masonry company intended to perform the contract when they did not actually intend to carry it out.

The complaint can be viewed as emphasizing the masonry company's poor financial condition as evidence of this implied misrepresentation. The same can be said with regard to the allegations that the debtor allowed the masonry company's corporate status to lapse shortly after entering into the contract. The complaint does not explain how failure to file the annual report and maintain the masonry company's corporate status could have caused the injury to the cemetery company. Nevertheless, the almost immediate failure to file the report and maintain the masonry company's corporate status suggests the masonry company was beyond saving when it made the contract and the principals in the masonry company knew it. The complaint also alleges the debtor made knowingly false statements regarding delivery of the pavers to induce the cemetery company to make the second payment. Even though this could not have occurred before the contract was made, such evidence can reflect on the debtor's earlier intent. The court concludes that the complaint under § 523(a)(2) does not rely entirely on an implied misrepresentation of the masonry company's financial condition or failure to disclose its financial condition; the complaint relies on an implied misrepresentation that the masonry company would carry out the contract. *McCallion v. Lane (In re Lane)*, 937 F.2d 694 (1st Cir. 1991); *Heeter v. Birt (In re Birt)*, 173 B.R. 346 (Bankr. N. D. Ohio 1994).

The debtor also argues that proof of the masonry company's poor financial condition can not by itself prove lack of intent to carry out the contract. The debtor makes

this argument by analogy to the credit card cases. Use of a credit card is an implied representation of the intent to pay the resulting debt – not an implied representation of financial ability to pay it. Furthermore, the court must consider the totality of the circumstances to decide whether the debtor had the subjective intent to repay the debt. *Rembert v. AT & T Universal Card Services, Inc. (In re Rembert)*, 141 F.3d 277 (6th Cir. 1998) *cert. den.* 525 U.S. 978, 119 S.Ct. 438, 142 L.Ed.2d 357 (1998). By analogy, when a construction company enters into a contract, it makes an implied representation of the intent to carry out the contract – not an implied representation of financial ability to carry it out. Furthermore, since the court must consider the totality of the circumstances to determine the debtor's subjective intent, the masonry's company poor financial condition can not by itself prove the intent not to carry out the contract. The debtor's argument must fail because, as already pointed out, the complaint relies on facts other than the masonry company's poor financial condition as evidence the debtor and the masonry company did not intend to carry out the contract.

The debtor also contends the cemetery company cannot possibly prove an intent not to carry out the contract. The debtor bases this argument on the masonry company's delivery of some of the pavers called for in the contract. According to the debtor, this attempt at performance negates any inference that the debtor and the masonry company did not intend to carry out the contract. The court disagrees. A person who does not intend to carry out a contract may carry out visible preparations or begin performance for a variety of reasons. It may be nothing more than a means of collecting more money from the other party before it discovers the fraud. It may also be a means of delaying the other party's decision to reclaim, to rescind, or to bring suit. As to this argument, an

analogy to the credit card cases is useful again. When a debtor makes payments on a credit card debt after the charges in question, the payments are evidence the debtor intended to pay the charges, but the payments do not necessarily prove the debtor intended to pay them. *Citibank (South Dakota) v. Eashai (In re Eashai)*, 87 F.3d 1082 (9th Cir. 1996) (payments using other credit card).

The complaint is lacking in allegations to show that the cemetery company justifiably relied on implied representations made by the debtor. *Field v. Mans*, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). There may be few facts the cemetery company can plead to show justifiable reliance, but they can still be alleged. The court will allow the cemetery company to amend the complaint to add such allegations.

Finally, the court should point out that the allegations regarding the second payment can be taken as a separate, independent claim under § 523(a)(2)(A). This claim does not depend on the theory that the debtor and the masonry company never intended to carry out the contract. It does not depend on failure to reveal the masonry company's poor financial condition or on an implied representation that the masonry company had the financial ability to carry out the contract. It does raise the problem of distinguishing between mere breach of a promise and making a false promise.

If a person obtains payment by honestly promising to deliver goods on a certain date, but then fails to deliver on that date, the person's honesty in making the promise means there was no fraud or false pretenses or false representation. On the other hand, if a person obtains payment by falsely promising to deliver on a certain date – by

making the promise without the intent to perform – he can be liable for obtaining the payment by fraud, false pretenses, or false representation. *See, e.g., Clayton Brokerage Co. v. Teleswitcher Corp.*, 555 F.2d 1349 (8th Cir. 1977); *Planters & Growers Golden Leaf Warehouse v. Baird (In re Baird)*, 229 B.R. 361 (Bankr. D. S. C. 1997); *Spectra Plastics, Inc. v. Nashoba Bank*, 15 S.W.3d 832 (Tenn. Ct. App. 2000); *Elliott v. Shore Stop, Inc.*, 384 S.E. 2d 752 (Va. 1989); Restatement (Second) Torts §§ 525 & 544. The cemetery company's complaint alleges that the debtor falsely promised delivery on certain dates. The court rejects the argument that dismissal should be required because the complaint alleges nothing more than a breach of contract as to the delivery date.

This distinction between an honest promise and a false promise can be argued as to the entire complaint, not just the delivery dates. The court's reasoning remains the same. The complaint asserts more than just a failure by the masonry company to carry out the contract. It asserts a false representation that the debtor and the masonry company intended to carry out the contract.

For these reasons, the court will deny the motion to dismiss with regard to § 523(a)(2)(A) and allow the cemetery company the opportunity to amend to allege justifiable reliance.

Larceny under § 523(a)(4) & willful and malicious injury under § 523(a)(6)

Larceny under § 523(a)(4) may overlap obtaining property by fraud, false pretense, or false representation under § 523(a)(2). *Allstate Life Ins. Co. v. Guerrerio (In re Guerrerio)*, 143 B.R. 605 (Bankr. S. D. N. Y. 1992). Since the court has decided not to

dismiss the claims under § 523(a)(2)(A), the court will not dismiss the larceny claim under § 523(a)(4).

Courts have held that obtaining property by fraud, false pretense, or false representation may be a willful and malicious injury (other than conversion). Sections 523(a)(2)(A) and 523(a)(6) are not mutually exclusive; both can apply to the same conduct except that an unwritten representation of financial condition may not prove a willful and malicious injury. *See*, *e.g.*, *Myers v. Ostling (In re Ostling)*, 266 B.R. 661 (Bankr. E. D. Mich. 2001); *Jeffrey M. Goldberg & Assocs. v. Holstein (In re Holstein)*, 272 B.R. 463 (Bankr. N. D. Ill. 2001); *Japra v. Apte (In re Japra)*, 180 B.R. 223 (9th Cir. B.A.P. 1995); *Lerch v. Iommazzo (In re Iommazzo)*, 149 B.R. 767 (Bankr. D. N. J. 1993).

For an injury to be willful and malicious, the debtor must have acted with the intent to cause harm to the creditor and without a just cause or excuse for the intent to cause harm. *Kawaahuau v. Geiger*, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998). The allegations of the complaint weakly allow the inference that the debtor acted willfully and maliciously. Furthermore, the cemetery company may be able to prove facts, consistent with the allegations of the complaint, to show that the debtor's actions were willful and malicious and caused injury to the cemetery company. The court will deny the motion to dismiss as to § 523(a)(6).

This Memorandum constitutes findings of fact and conclusions of law as required by *Fed. R. Bankr. P.* 7052.

ENTER:

BY THE COURT

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

(Entered 5/09/03)

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE
SOUTHERN DIVISION

In re:

MICHAEL STROCK

Debtor

No. 02-13533
Chapter 7

McGLOTHLIN FAMILY CEMETERY COMPANY

Plaintiff

v.

MICHAEL STROCK

Defendant

Adversary Proceeding
No. 02-1176

ORDER

In accordance with the court's memorandum opinion entered this date,

It is ORDERED that the defendant's motion to dismiss the complaint is granted and the complaint is dismissed to the extent the complaint asserts that (A) the defendant owes the plaintiff a debt for fraud or defalcation while acting in a fiduciary capacity that is non-dischargeable under 11 U.S.C. § 523(a)(4); (B) the defendant owes the plaintiff a debt for embezzlement that is non-dischargeable under 11 U.S.C. § 523(a)(4); (C) the defendant owes the plaintiff a debt for willful and malicious conversion of the plaintiff's property that is non-dischargeable under 11 U.S.C. § 523(a)(6); (D) the defendant owes the plaintiff a debt that is non-dischargeable under 11 U.S.C. § 523(a)(2)

based on implied misrepresentations of the financial condition of the defendant or Architectural Stone, Inc., the corporation in which he was a shareholder;

It is FURTHER ORDERED that the plaintiff is granted 20 days after the date of entry of this order to amend the complaint with regard to the dismissed claims listed above and to amend the complaint to allege facts relevant to justifiable reliance under 11 U.S.C. § 523(a)(2)(A).

ENTER:

BY THE COURT

_____
R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

(Entered 5/9/03)